No. 601

In the Supreme Court of the United States

OCTOBER TERM, 1941

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE, PETITIONER

v.

WASHINGTON, BALTIMORE, AND ANNAPOLIS REALTY CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The opinion of the District Court (R. 111–116) is reported at 35 F. Supp. 340. The opinion of the United States Circuit Court of Appeals for the Fourth Circuit (R. 123–127) is reported at 120 F. (2d) 441.

JURISDICTION

The judgment below was entered on June 11, 1941 (R. 128). The petition for a writ of certiorari was filed September 10, 1941, and was granted October 27, 1941. The jurisdiction of this Court

is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The taxpayer corporation was organized for the purpose of and engaged in liquidating the assets of another corporation. The capital stock tax is imposed upon corporations "carrying on or doing business" within the tax year. The applicable Treasury Regulations have provided since 1919 that doing business includes such liquidation activities. The questions presented are whether the regulations have so far departed from the statute as to be invalid, and, whether, in any event, the taxpayer's activities are within the statute irrespective of the regulations.

STATUTES AND REGULATIONS INVOLVED

The pertinent portions of the applicable statutes and regulations are set forth in the Appendix, *infra*, pp. 27—38.

STATEMENT

This case involves capital stock taxes for the years ending June 30, 1936, through 1939. The respondent corporation was organized September 30, 1935, under the laws of Maryland relating to business corporations, by the protective committee for the bondholders of the Washington, Baltimore & Annapolis Electric Railway Company (R. 117–118). The committee had acquired through fore-

closure certain properties belonging to the railroad company, and the respondent corporation was organized in order to permit the liquidation of these properties in an orderly manner (R. 117–118). Its charter gave respondent broad powers, including the power to buy, sell, lease, develop and otherwise deal in land, loan and borrow money, conduct a general brokerage business, deal in personal property, and carry on any business incidental to its activities (R. 5–6). The stock of the corporation was distributed to the former bondholders on the basis of one share for each $1,000 bond held (R. 117–118).

The properties acquired by the taxpayer consisted of certain rights-of-way, easements, terminal properties and other real estate located in Baltimore, Annapolis and Washington, as well as at other points along the line of the railroad. Included among the assets received was the entire stock of a realty holding company which, in turn, owned another realty company, both of which had been subsidiaries of the railroad and performed no function other than that of holding legal title to real estate (R. 118).

Since its incorporation respondent has been engaged in carrying on negotiations for the sale of the properties acquired, selling them from time to time as satisfactory offers were received, and renting unsold properties under short term leases in "an attempt to earn the carrying charges * * *

pending their ultimate sale."[1] (R. 118). Respondent has repaired the property, and paid taxes, insurance premiums and other expenses (R. 79–82). Respondent has been managed by its three officers and directors, who received nominal salaries except on one occasion when a substantial bonus was paid them (R. 99, 82), and its attorney (R. 17–76). Its only other employee was a part-time auditor (R. 118, 72).

The minutes of the respondent's directors' meetings (R. 17–76) disclose continuous activity during the years in controversy, involving numerous negotiations for the sale of various items of property and equipment and for the leasing of unsold property. They show, in addition, that in 1936 respondent purchased certain equipment from the Boston Iron and Metal Company in order to resell it to the Pennsylvania Railroad (R. 19–20, 104–105).[2]

The value of the properties received by respondent in 1935, as shown by respondent's balance sheet, was $410,250 (R. 77). During the next four years portions of this property were sold for approximately $675,000, some being sold each year (R. 80–82). At the end of this period respondent's books still showed property worth $122,000 (R. 79).

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[1] Resp. Brief in Circuit Court of Appeals, p. 18.

[2] The tracks and transmission lines on a part of respondent's roadbed sold to the Pennsylvania Railroad had previously been sold by respondent to the Boston Iron and Metal Company. It was necessary for respondent to buy these properties back in order to get the Pennsylvania to purchase that portion of its right-of-way (R. 104–105).

During the four-year period respondent received in rentals $136,000 (R. 80–82). Respondent's annual statements show that large disbursements were made for taxes, that commissions paid on sales and rentals amounted to approximately $24,000, that expenditures for repairs were over $3,400, for insurance $8,800, for engineering expenses $23,000, for legal fees $30,000, for auditing and stenographic services $3,000, and for special compensation to directors and Secretary, $12,500 (R. 80–82).

All net income, except reserves for contingencies, was distributed to the stockholders as received. The total amount paid them by December 31, 1939, was $75 per share. With prior distributions, this gave each bondholder of the railroad company $176 on his $1,000 bond [3] (R. 107–109, 118). By that time the book value per share of respondent's stock was $20.68 (R. 118).

For the years ending June 30, 1936, through June 30, 1939, respondent paid capital stock taxes of $6,000, $5,985, $3,000 and $3,005, respectively (R. 119). It brought suit for refund in the District Court. That court held that because respondent was a liquidating corporation, it was not carrying on or doing business and was therefore exempt from the tax (R. 113–119). The Circuit Court of Appeals affirmed (R. 123–127).

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[3] The 8 percent of the bondholders who had not deposited their bonds with the protective committee had previously been paid $175 (R. 107–108).

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in holding and deciding that the taxpayer was not carrying on or doing business within the meaning of the applicable statutory provisions.

2. The Circuit Court of Appeals erred in failing to give effect to the applicable Treasury Regulations.

3. The Circuit Court of Appeals erred in affirming the judgment of the District Court.

SUMMARY OF ARGUMENT

Respondent concedes that its conduct constitutes doing business under a specific provision of the Treasury Regulations, but contends that the regulation is invalid. The regulation, which has been in effect since 1918, is a reasonable and permissible construction of a statute the meaning of which has been recognized by other circuit courts of appeals to be not at all clear.

Even apart from the regulations, respondent's conduct would constitute doing business. Selling, renting, and managing real property has frequently been held to be doing business within the meaning of the Act, even when the amount of such activity has been slight. Respondent does not merely own property and engage in conduct incidental to the distribution of the avails.

The fact that respondent was created as a liquidating corporation does not mean that it is not doing business. Even though an ordinary business

corporation, which has abandoned its primary enterprise and is disposing of its assets, might not be regarded as engaged in business, liquidation is the business of respondent. Since respondent was engaged in activity ordinarily carried on for profit, it is immaterial whether or not respondent was seeking profit. In fact, however, respondent was not only seeking but actually made a substantial profit in selling the property entrusted to it. The prior losses of the Electric Railroad Company and its bondholders are not attributable to respondent, an entirely separate entity.

ARGUMENT

THE CORPORATION WAS DOING BUSINESS IN THE YEARS INVOLVED AND IS SUBJECT TO THE CAPITAL STOCK TAX

A. THE REGULATIONS

This case involves the question whether a corporation organized to acquire and liquidate the assets of another corporation and engaged in disposing of those of the assets for which a satisfactory price can be obtained, meanwhile leasing the balance, is "carrying on or doing business" within the meaning of the capital stock tax[4] (I. R. C., Sec.

[4] The question under the capital stock tax is not to be confused with the question whether an individual is engaged in carrying on a trade or business so as to be entitled to a deduction under provisions like Section 23 (a) of the Revenue Act of 1934, which authorize the deduction from gross income of "the ordinary and necessary expenses paid or incurred * * * in carrying on any trade or business

1200).[5] The tax in question, or its predecessors, have been in effect since 1916,[6] except for a hiatus between 1926 and 1933. Treasury Regulations 38, issued under the 1916 Act, declared that (Article 5):

> * * * A corporation formed to take over miscellaneous stocks, bonds, and other property, to negotiate the sale of the various items from time to time as opportunity and judgment dictate, and to distribute the proceeds from time to time as liquidation is effected, is organized for profit and while engaged in such liquidation is carrying on business.

This provision of the applicable regulations, with inconsequential changes of wording, remained

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* * *." This Court has expressly recognized that difference tests are to be applied in giving effect to such provisions. *Higgins* v. *Commissioner*, 312 U. S. 212, 217; *United States* v. *Pyne*, 313 U. S. 127, 131.

[5] This case involves taxes for the fiscal years ending June 30, 1936, through June 30, 1939, and thus arises under the Revenue Act of 1935, Sec. 105 (c. 829, 49 Stat. 1014), Revenue Act of 1936, Sec. 401 (c. 690, 49 Stat. 1648), and Revenue Act of 1938, Sec. 601 (c. 289, 52 Stat. 447). These statutory provisions are identical, and will be referred to for convenience as now set forth in I. R. C., Sec. 1200.

[6] Revenue Act of 1916, Sec. 407 (c. 463, 39 Stat. 756), Revenue Act of 1918, Sec. 1900 (c. 18, 40 Stat. 1057), Revenue Act of 1921, Sec. 1000 (c. 136, 42 Stat. 227), Revenue Act of 1924, Sec. 700 (c. 234, 43 Stat. 253), National Industrial Recovery Act, Sec. 215 (c. 90, 48 Stat. 207), Revenue Act of 1934, Sec. 701 (c. 277, 48 Stat. 680) and Acts cited in preceding footnote. Differences between the 1916 Act and its successors are noted below, *infra*, p. 24.

in effect through the 1934 edition[7] of the regulations. In 1936 the regulations were reorganized, but not so as to change the substance of the provision quoted above. Since 1936[8] Article 43 of Regulations 64 has provided:

> ART. 43. *Illustrations.*—(*a*) *General.*—In general "doing business" includes any activities of a corporation whether it engages in—
>
> * * * * * *
>
> (5) The orderly liquidation of property by negotiating sales from time to time as opportunity and judgment dictate and distributing the proceeds as liquidation is effected—for example, the liquidation of an estate, or of properties taken over from another corporation, or of the shareholders' fractional interests in particular property;
>
> * * *

That the latter regulation applies to the taxpayer has been conceded by respondent and the lower courts. If the regulation is valid, respondent is not entitled to prevail.

Respondent and the courts below have found the regulation to be invalid because in conflict with the "plain meaning of the statute" (R. 127, Br. in Opp., p. 5).

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[7] Treasury Regulations 50 (1919 ed.), Art. 18; (1920 ed.), Art. 11; Treasury Regulations 64 (1922 ed.), Art. 12; (1924 ed.), Art. 12; (1933 ed.) Art. 22; (1934 ed.), Art. 33.

[8] Treasury Regulations 64 (1936 ed.), Art. 43; (1938 ed.), Art. 43.

It is, of course, true that, as applied to most corporations, the meaning of the phrase "carrying on or doing business" is perfectly clear. But as other circuit courts of appeals have recognized in dealing with similar problems, in close cases "the criterion is none too sharply defined" (*American Investment Securities Co.* v. *United States*, 112 F. (2d) 231, 232 (C. C. A. 1)). Decision in "perplexing" cases "on the borderline" has been said to be determined "very much according to the mental view point of the judge rather than decision controlled by some definite principles" (*Harmar Coal Co.* v. *Heiner*, 34 F. (2d) 725, 727 (C. C. A. 3), certiorari denied, 280 U. S. 610). And in *Argonaut Consolidated Mining Co.* v. *Anderson*, 52 F. (2) 55 (C. C. A. 2), certiorari denied, 284 U. S. 682, Circuit Judge Learned Hand declared that "the decisions in the lower courts represent so many variants that it is scarcely possible to consider them; as in so many other matters we have to mark off a zone of increasing impenetrability rather than to draw a line."*

Such an opaque and undefined field was a "peculiarly appropriate" one for administrative interpretation (*Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 102). Here, as in statutes using such expres-

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*The same court and the Circuit Court of Appeals for the Ninth Circuit have also made reference to the "decisions on this tangled subject." *Eaton* v. *Phoenix Securities Co.*, 22 F. (2d) 497 (C. C. A. 2); *United States* v. *Hotchkiss Redwood Co.*, 25 F. (2d) 958 (C. C. A. 9).

sions as "net income * * * from the property",[10] or "ordinary and necessary",[11] "the Congress has not prescribed a precise formula free from all ambiguity" (*ibid.*), or used terms "so clear and unambiguous in their meaning and application as to leave no room for an interpretative regulation" (*Textile Mills Securities Corp.* v. *Commissioner*, No. 34, this Term, pamph. p. 9). As was true in the *Textile Mills* case, the numerous cases and the fine distinctions drawn by the lower courts on this subject "bear witness" to the need for administrative implementation (*ibid.*).

Here the regulation in question has been in effect ever since 1918,[12] covering a period in which the statute has been reenacted seven times. The regulation thus represent a contemporaneous and long-continued administrative interpretation of the statute, and, accordingly, is entitled to great weight. *Brewster* v. *Gage*, 280 U. S. 327; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375; *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488; *United States* v. *Shreveport Grain & El. Co.*, 287 U. S. 77; *Textile Mills Securities Corp.* v. *Commissioner*, No. 34, this Term.[13]

[10] Revenue Act of 1928, Sec. 114 (b) (3), 45 Stat. 791, 821; *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 102.

[11] Revenue Act of 1928, Sec. 23 (a), 45 Stat. 791, 799; *Textile Mills Securities Corp.* v. *Commissioner*, No. 34 this Term

[12] Except for the period during which the tax itself was not in existence.

[13] It has frequently been held that the successive reenactments of a statute while a regulation is in effect lend even

B. APART FROM THE REGULATIONS, RESPONDENT'S ACTIVITIES CONSTITUTE "DOING BUSINESS"

We submit that not only is the regulation here a permissible and reasonable interpretation of the law, and obviously not in conflict with it, but that the same conclusion would follow if there were no regulation at all.[14] The following considerations will support both of these propositions:

During the tax years respondent was engaged in selling, renting, and managing real property. Such activities, apart from the liquidation aspects of the case, to be discussed below (*infra*, pp. 16–26) are unquestionably "doing business" within the meaning of the law. Since the first decisions under the 1909 tax on the incomes of corporations "carrying on or doing business", it has been recognized that companies engaged in selling, leasing, and managing real estate are taxable. *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 169–171;[15] *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503; *Page* v. *M.*

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greater weight to its validity. Cf. *Morgan* v. *Commissioner*, 309 U. S. 78, 81; *Helvering* v. *Winmill*, 305 U. S. 79, 83; *Old Mission Co.* v. *Helvering*, 293 U. S. 289, 293–294.

[14] The lower courts' decisions in this case turned upon an interpretation of the law as not applicable to liquidating corporations, and accordingly are not binding upon this Court as findings of fact. Cf. *Powers* v. *Commissioner*, 312 U. S. 259; *United States* v. *Pyne*, 313 U. S. 127; *Helvering* v. *Tex-Penn Co.*, 300 U. S. 481; *Bogardus* v. *Commissioner*, 302 U. S. 34.

[15] A number of the parties to the group of cases passed upon in the opinion in *Flint* v. *Stone Tracy Co.* were real estate corporations.

Rich & Bros. Co., 99 F. (2d) 607 (C. C. A. 5), certiorari denied, 306 U. S. 662; *Harmar Coal Co.* v. *Heiner*, 34 F. (2d) 725, 727 (C. C. A. 3), certiorari denied, 280 U. S. 610; *United States* v. *Peabody Co.*, 104 F. (2d) 267 (C. C. A. 6).

Furthermore, it has been frequently declared that the statute "requires no particular amount of business in order to bring a company within its terms." *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. at 517; *Page* v. *M. Rich & Bros. Co.*, 99 F. (2d), at 610; *Argonaut Consolidated Mining Co.* v. *Anderson*, 52 F. (2d) 55 (C. C. A. 2), certiorari denied, 284 U. S. 682; *American Investment Securities Co.* v. *United States*, 112 F. (2d) 231 (C. C. A. 1); cf. *Edwards* v. *Chile Copper Co.*, 270 U. S. 452. In the cases cited the quantity of business carried on by the corporations involved was not substantial, and was fairly comparable to the activities of respondent here. Thus, in the *Von Baumbach* case the corporation had leased its mineral lands, received the rentals, employed another company to inspect the properties for it, and sold and rented certain minor portions of its other real estate.

The present case is not governed by the authorities and the Regulation (Article 43 (b) (2))[16] holding the tax inapplicable to corporations engaged in the mere ownership and holding of property and the distribution of the avails. Under

[16] See Appendix, *infra*, p. 29.

these authorities a corporation owning or leasing property and doing nothing but distributing the proceeds therefrom to its stockholders is not regarded as engaged in business. *Zonne* v. *Minneapolis Syndicate*, 220 U. S. 187; *McCoach* v. *Minehill & S. H. R. Co.*, 228 U. S. 295; *United States* v. *Emery*, 237 U. S. 28.[17] The *McCoach* case, in which a divided court apparently extended this doctrine to such acts necessary to the maintenance of the property as the investment and reinvestment of the rentals, seems to have been limited to its facts by subsequent decisions. Cf. *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503; *Edwards* v. *Chile Copper Co.*, 270 U. S. 452; *Argonaut Consolidated Mining Co.* v. *Anderson*, 42 F. (2d) 219, 221 (District Judge Patterson), affirmed 52 F. (2d) 55 (C. C. A. 2), certiorari denied, 284 U. S. 682; *Page* v. *M. Rich & Bros. Co.*, 99 F. (2d) 607 (C. C. A. 5), certiorari denied, 306 U. S. 662; *United States* v. *Peabody Co.*, 104 F. (2d) 267 (C. C. A. 6); *United States* v. *Hercules Mining Co.*, 119 F. (2d) 288 (C. C. A. 9), certiorari denied, No. 522, this Term; *United States* v. *Hotchkiss Redwood Co.*, 25 F. (2d) 958, 959 (C. C. A. 9). In any event the activity of respondent here in selling, renting, and managing real property goes considerably further than the mere receipt and investment of the proceeds involved in the *McCoach* case.

[17] The cases cited arose under the 1909 Act referred to *infra*, p. 24.

Subsequent decisions have required very little activity in addition to the holding of property and distribution of the proceeds to bring a corporation within the tax. The test which these cases establish has been summarized by Judge Learned Hand in the *Argonaut* case as follows (52 F. (2d), at 56):

> Just what activities bring a corporation within the statutory definition the decisions, as is almost inevitable, do not certainly declare. That there is a degree of quietude which will exempt it, is indeed well settled [*Zonnie* v. *Minneapolis Syndicate*, 220 U. S. 187, 31 S. Ct. 361, 55 L. Ed. 428; *McCoach* v. *Minehill, etc., Co.*, 228 U.S. 295, 33 S. Ct. 419, 57 L. Ed. 842; *U. S.* v. *Emery, etc., Co.*, 237 U.S. 28, 35 S. Ct. 499, 59 L. Ed. 825; *Eaton* v. *Phoenix Securities Co.*, 22 F. (2d) 497 (C.C.A. 2); *Rose* v. *Nunnally Co.*, 22 F. (2d) 102 (C.C.A. 3)]; but how far it may be active and still maintain its exemption, is in the nature of things impossible of statement in general terms. In most of those cases in which the corporation has succeeded its activities have been confined to holding the title of property, whose usufruct it receives and distributes in dividends. When this is the whole scope of its dealings, it does no business within the meaning of the statute.
>
> However, it takes little to bring it from behind this shield. Thus, selling and leasing land, and exploring for ore, were enough in *van Baumbach* v. *Sargent Land Co.*, 242 U.S.

503, 37 S. Ct. 201, 61 L. Ed. 460; and borrowing money to assist the subsidiary in *Edwards* v. *Chile Copper Co.*, 270 U.S. 452, 46 S. Ct. 345, 70 L. Ed. 678. On the other side the investment of its funds in current securities from which income is derived was not enough in *McCoach* v. *Minehill, etc., Co.*, 228 U.S. 295, 33 S. Ct. 419, 57 L. Ed. 842.

The test to be applied is, whether a corporation is (*id.*, at 57) "outside the class of those inert companies, which can assert that they are mere dry holders of property, and conduits to carry over its profit to the persons eventually entitled." See also *American Investment Securities Co.* v. *United States*, 112 F. (2d), at 233.

The activities and expenditures of respondent as outlined in the Statement (pp. 3–6, *supra*) clearly show that it does not come within the class of "inert or dry holders of property" which are exempt from the law.

C. THE FACT THAT RESPONDENT WAS A LIQUIDATING CORPORATION DOES NOT MEAN THAT IT WAS NOT DOING BUSINESS

The court below, although conceding that very slight activity would constitute doing business under the statute when the end is profit, held that because the respondent's object was liquidation of the assets entrusted to it, rather than profit, it was not doing business (R. 126–127).

1. *The argument as to liquidation.*—The fact that a corporation's activities consist of liquida-

tion of assets does not mean that it is not engaged in business. In a sense every mining or other wasting asset corporation is engaged in the liquidation of its assets.[18] The question, we submit, is not whether a corporation intends to continue doing business after the property presently owned is disposed of, but whether it *is* doing business at the time it is disposing of the property. The nature of the activities during the taxable period, not the intention as to what the company will or will not do in the future, must be controlling.

It is true that cases in the lower courts have regarded the fact that a corporation was in liquidation as of some consequence. It has been held that if a corporation formed for the purpose of carrying on some ordinary business activity abandons this primary enterprise and engages solely in the liquidation of its assets, it is no longer doing business. *Union Land & Timber Co.* v. *United States*, 65 C. Cls. 129; *Johnson's Estate* v. *United States*, 37 F. Supp. 617 (C. Cls.); *S. Makransky & Sons, Inc.* v. *United States* (E. D. Pa.), October 14, 1940, 1940 C. C. H. Fed. Tax Service, Vol. 4, Par. 9713. Whether or not this should be the rule when the activities of a corporation in

[18] The taxability of a wasting asset corporation is clear, Cf. *Harmar Coal Co.* v. *Heiner*, 34 F. (2d) 725 (C. C. A. 3), certiorari denied 280 U. S. 610; *United States* v. *Hercules Mining Co.*, 119 F. (2d) 288 (C. C. A. 9), certiorari denied No. 522, this Term; *Lyon Lumber Co.* v. *Harrison*, 113 F. (2d) 443 (C. C. A. 7).

liquidation would otherwise constitute carrying on business, they have no application to a company formed with the express object of facilitating the liquidation of property previously belonging to the stockholders. It might be said in a colloquial sense that a railroad which ceased to operate and which was engaged solely in disposing of its real property was no longer engaged in business. But a corporation such as respondent, established specially for the purpose of disposing of such property, would be doing the very thing for which it was created. Liquidation is the business of such a corporation."[19]

The only cases directly in point hold that a corporation formed for the purpose of liquidating property is subject to the tax so long as it is engaged in the sale, renting and management of the property entrusted to it. *Edgar Estates Corporation* v. *United States*, 65 C. Cls. 415; *Conhaim Holding Co.* v. *Willcuts*, 21 F. (2d) 91 (D. Minn.).[20] The corporation involved in the *Edgar* case was organized for the express purpose of acquiring the corpus of an estate and liquidating it in an orderly manner, renting such property as could not be imme-

[19] The fact that a company is established under a state business corporation law (R. 6, 117), though not at all conclusive, is some indication that it is engaged in business when it is doing precisely that for which it was created.

[20] *Clallam Lumber Co.* v. *United States*, 34 F. (2d) 944, 947, 37 F. Supp. 542 (W. D. Mich.), although distinguishable on its facts, seems to take a contrary view, and was, we believe, erroneously decided.

diately sold at a favorable price, and in general operating precisely as did the taxpayer. The reasoning of the opinion of the Court of Claims is directly in point here (pp. 422–423):

> * * * The plaintiff in this case was prompted to incorporate in view of a situation wherein incorporation offered, at least in the opinion of the stockholders, a distinct advantage and profit over the ordinary course of law applicable to their situation. * * * *while the detail of activities resembles a process of liquidation, it is to be remembered that that is precisely the purpose of the incorporation, its one object to the discharge of which all business activities were solely directed.* * * * The fact that overhead expense was nominal, proven profits from investments small, and business activities not especially exacting in nowise militates against the rule. If the corporation was pursuing the object for which it was organized and doing all the essential things to accomplish that object, it cannot claim a classification of an inactive corporation, doing no more than liquidating its assets. It is not the amount of business done which signifies, although in this case it is apparent that the corporation did conserve and save to the estate expenses which otherwise it would have incurred, and likewise enabled the stockholders to await a propitious moment for sales of real estate, as well as enable

> the corporation to collect rents, maintain the property, and make small investments. * * * * [Italics supplied.]

Cases which respondent claims to be inconsistent with the above doctrine fall into two categories. They involve either the class described above (p. 17), of corporations winding up their own previously active operations in another field and not formed for liquidation purposes, or corporations which were formed with the object of disposing of property but which the Court regarded as not actively engaged in the disposal of the property during the taxable period. *Cannon* v. *Elk Creek Lumber Co.*, 8 F. (2d) 996 (C. C. A. 7); *Sears* v. *Hassett*, 111 F. (2d) 961 (C. C. A. 1) [21]; cf. *United States* v. *Hotchkiss Redwood Co.*, 25 F. (2d) 958 (C. C. A. 9); *Lane Timber Co.* v. *Hynson*, 4 F. (2d) 666 (C. C. A. 5).[22] A liquidating corporation, just as any other "inert" corporation, might not be doing business when engaged solely in owning and maintaining its property [23] (see p. 16,

[21] With respect to the *Cannon* and *Sears* cases respondent's brief in the Circuit Court of Appeals (p. 20) stated that the corporations, "though formed to liquidate, and having done so for a time, during the taxable year, were merely holding the balance of their assets pending an ultimate sale."

[22] The two cases last cited involved corporations formed for the purpose of holding land for a profitable sale, not liquidation, but which in fact "never did more than passively hold it". (Respondent's brief in the Circuit Court of Appeals, p. 14).

[23] A corporation organized for the purpose of liquidation might be carrying on business even though its activities

supra.) The cases cited merely show that the eagerness of such corporations, like other owners of property, to sell if an adequate price is received does not bring them within the statute during a period in which no sales are made or property rented.

2. *The argument that petitioner was not organized for profit.*—The court below held that respondent was not doing business because it was not organized for profit. This ruling is incorrect both on the facts and as a matter of law.

(a) Here the taxpayer was plainly trying to make as much money as possible out of the disposal of its assets. Its balance sheet on December 31, 1935, before the sale of any of the property acquired from the bondholders, showed real estate worth $119,250. The statements of receipts and disbursements and balance sheets for the years 1935 through 1939 (R. 77-82) show sales of real estate totaling about $675,000 and property still held on December 31, 1939, valued at $122,000. This in itself would show a gain or profit of almost $375,000 or about 90 percent on the original assets. In addition respondent had received rents exceeding $130,000 (*ibid*). The results were so satisfactory to the stockholders that substantial bonuses were paid the directors and officers of the company (R. 82, 99). In such circumstances it is

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would be less than sufficient to bring within the statute a corporation created for other purposes.

absurd to say that respondent was not organized for profit, or that during the taxable year it did not in fact make a profit.

The court below, in reaching the contrary conclusion, seems to have confused respondent corporation with its stockholders, the bondholders of the defunct railroad company. It is, of course, true that the losses of the railroad were much greater than anything the bondholders might recover through the activities of respondent, and that these bondholders, who were respondent's stockholders, would lose heavily, irrespective of what respondent might do.[24] But the inability of the bondholders to recover their full investment in the railroad is not attributable to respondent, and does not mean that respondent was not operating profitably. Any determination as to whether respondent was making profits must be based upon the value of the property with which it began business, without regard for the losses previously incurred by the railroad.

The railroad corporation, its bondholders, and respondent are all separate and distinct entities, and must be so treated when it comes to paying taxes as well as when separation is beneficial to them. As this Court recently stated, "The choice of disregarding a deliberately chosen arrangement

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[24] The record indicates that by the end of the taxable period each bondholder had received $176 on each thousand-dollar bond (R. 107-108).

for conducting business affairs does not lie with the creator of the plan." *Gray* v. *Powell*, No. 18, this Term, pamph. p. 9; see also *Higgins* v. *Smith*, 308 U. S. 473, 477; *Edwards* v. *Chile Copper Co.*, 270 U. S. 452, 456.

(b) In any event, we submit, a corporation may be engaged in business even if it is not concerned with gains or profits. Article 42 of Regulations 64 has, since 1936, provided that:

> ART. 42. *Doing business.*—The term "business" is very comprehensive and embraces whatever occupies the time, attention, or labor of men for profit. Accordingly, regardless of the nature of its activities, any corporation organized for profit and carrying out the purpose of its organization is doing business within the meaning of the Act. *Similarly, even if not organized for profit, any corporation which nevertheless engages in activities ordinarily carried on for profit is also doing business.* It is immaterial whether the activities result in a profit or loss, whether the corporation has been successful in its enterprise, or that because of unfavorable business conditions, no operations are carried on for a particular period. No particular amount of business need be done, nor is it necessary that the business be continuous throughout the taxable year. [Italics supplied.]

This interpretation of "doing business" as applied to corporations engaged "in activities

ordinarily carried on for profit" is entirely reasonable. For example, a corporation operating a professional baseball team might be owned and controlled by an individual motivated entirely by his interest in the sport and not at all concerned with whether the company was operating at a profit or a loss. The company would nevertheless be carrying on or doing business.

The corporation tax of 1909 [25] and the first capital stock tax of 1916 [26] on corporations carrying on or doing business applied in terms to corporations "organized for profit." In the *Von Baumbach* case this Court seems to have assumed (242 U. S., at 514) that corporations were organized for profit unless they came "within the exceptional character of charitable or eleemosynary organizations excepted from the operation of the act".[27] This conception of the meaning of the words "organized for profit" would appear to have made the phrase

[25] Act of August 5, 1909, Sec. 38, c. 6, 36 Stat. 11, 112.

[26] Revenue Act of 1916, Sec. 407, c. 463, 39 Stat. 756.

[27] The District Court in the *Von Baumbach* case, whose decision was affirmed by this Court on the point, declared (207 Fed. 423, at 428): "* * * my present opinion is that the words 'organized for profit' are used to distinguish these corporations from charitable corporations; that any corporation organized by private persons for their own advantage and interest, and not for social, charitable, or beneficent purposes, is organized for profit; and that a company organized as these companies were, to acquire title to an estate for the purpose of liquidating it and dividing the proceeds among the owners, is organized for 'profit,' as that term is used in the act in question. * * *"

superfluous, in view of the exemption for charitable corporations contained in all of the corporation tax statutes since 1909.[28]

That such may have been the opinion of Congress appears from the fact that in the first reenactment[29] of the capital stock tax after the *Von Baumbach* decision the phrase "organized for profit" was deleted;[30] it has not reappeared in any of the subsequent Acts. This elimination of language identical with that which the court below has read back into the statute is not without significance. This Court has treated the omission of another restrictive phrase found in the 1909 and 1916 acts from the same section of the 1919 act as plainly manifesting a legislative intention that the scope of the tax was to be extended. *Hecht* v. *Malley*, 265 U. S. 144, 155.

There would, of course, have been no need for the exemption for charities if corporations doing business included only those organized for profit. We submit that the elimination of the requirement that the corporation be organized for profit, together with the retention of the exemption for charitable organizations, indicates that a non-charitable corporation may be doing business

[28] Act of August 5, 1909, Sec. 38, c. 6, 36 Stat. 11, 112, and revenue acts cited in Notes 5 and 6, *supra*, p. 8.

[29] Revenue Act of 1918, Sec. 1000, c. 18, 40 Stat. 1057.

[30] Our examination of the legislative history of this Act has not revealed any reference to or explanation of the elimination of the words "organized for profit."

within the meaning of the Act irrespective of the profit motive. Thus the legislative history supports the conclusion in Article 42 of the Regulations that engaging in activities *ordinarily* carried on for profit is doing business.

CONCLUSION

It is, therefore, respectively submitted that the decision of the court below is erroneous and should be reversed.

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FEBRUARY 1942.

APPENDIX

Internal Revenue Code, Sections 1200 (a) and 1201 (a) (1), which sections contain provisions found in the Revenue Act of 1935, Sec. 105, 49 Stat. 1017; Revenue Act of 1936, Section 401, 49 Stat. 1733; and Revenue Act of 1938, Sec. 601, 52 Stat 565, read as follows:

§ 1200. Tax—(a) *Domestic corporations.*

For each year ending June 30, beginning with the year ending June 30, 1939, there shall be imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1 for each $1,000 of the adjusted declared value of its capital stock.

* * * * *

§ 1201. *Exemptions.*

(a) The taxes imposed by section 1200 shall not apply—

(1) *Corporations exempt from income tax.*

To any corporation enumerated in section 101;

* * * * *

Internal Revenue Code, Section 101, referred to in Section 1201 (a) (1), reads in part as follows:

§ 101. *Exemptions from tax on corporations.*

The following organizations shall be exempt from taxation under this chapter—

* * * * *

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to

children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

* * * * * *

Treasury Regulations 64 (1936 Edition):

ART. 42. *Doing business.*—The term "business" is very comprehensive and embraces whatever occupies the time, attention, or labor of men for profit. Accordingly, regardless of the nature of its activities, any corporation organized for profit and carrying out the purpose of its organization is doing business within the meaning of the Act. Similarly, even if not organized for profit, any corporation which nevertheless engages in activities ordinarily carried on for profit is also doing business. It is immaterial whether the activities result in a profit or a loss, whether the corporation has been successful in its enterprise, or that because of unfavorable business conditions, no operations are carried on for a particular period. No particular amount of business need be done, nor is it necessary that the business be continuous throughout the taxable year.

The case is exceptional in which the activities of a corporation organized for profit do not amount to doing business within the meaning of the Act. Such a case is generally limited to one in which the corporation is not pursuing the ends for which organized, i. e., profit.

ART. 43. *Illustrations.*—(a) *General.*—In general "doing business" includes any activities of a corporation whether it engages in—

(1) buying, selling, manufacturing, developing, financing, speculating or otherwise dealing in property of any description;

(2) furnishing services of any character;

(3) leasing or managing properties, collecting rents or royalties;

(4) managing, financing, controlling or directing the operations, performing any function, or, in any other way, aiding or serving the general purposes of any affiliated or related company;

(5) the orderly liquidation of property by negotiating sales from time to time as opportunity and judgment dictate and distributing the proceeds as liquidation is effected—for example, the liquidation of an estate, or of properties taken over from another corporation, or of the shareholders' fractional interests in particular property; or

(6) any other activities coming within the ordinary and natural signification of the term "carrying on or doing business."

(b) *Exceptions.*—Ordinarily the exceptions to "doing business" are restricted to limited activities of a corporation, such as—

(1) the issuance and sale of its stock for cash as a preliminary step in the completion of its organization; or

(2) the distribution of the avails of property and the doing only of such acts as may be necessary for the maintenance of its corporate status in the case in which the corporation either was organized for, or has reduced its activities to, the mere owning and holding of specific property.

Nor will a corporation be regarded as "doing business" if it has *no* activities, because it has—

(3) become dormant; or

(4) completed its business, as, for example, a real estate subdivision developed, sold and reduced to cash; or

(5) abandoned its business, as, for example, where prospective oil properties are proven worthless.

If the corporation's activities are not so limited as outlined in the preceding paragraph, it will be regarded as "doing business" within the meaning of the Act. Thus, a corporation is "doing business" if—

(A) in addition to the activities described in paragraph (b) (1) it engages in any other activity such as the making of contracts, the buying of materials or machinery, the construction of buildings, or the employing or discharging of individuals; or

(B) in addition to the activities described in paragraph (b) (2) it engages in any other activity, such as (i) in the case of a company holding securities, the investment or reinvestment of surplus or other funds in excess of an amount necessary to maintain its original investments, or (ii) in the case of a company which had leased its property to another, the maintaining or keeping the property in repair in accordance with the terms of the lease, or in other activities necessary to enable the lessee properly to manage the leased property, regardless of whether such activities are performed on behalf and under the order of the lessee or that such acts are not of major importance; or

(C) although it retires from its principal business it nevertheless engages in other business activities or maintains its organization for the purpose of continued effort in the pursuit of profit or gain.

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